Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Evans	Analyst:	Angela Raygoza	Bill Number:	ABX1 2
Related Bills:	See Legislative History	Telephone:	845-7814	Amended Date:	December 18, 2008
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: PIT Rates/Impose Additional 2.5% Tax On Total Tax Beginning On Or After January 1, 2009/FTB Report The Increase In Revenue To Director Of Department Of Finance

SUMMARY

This bill would impose an additional tax on all personal income taxpayers equal to 2.5% of the taxpayer's total tax, as defined.

This analysis will not address the bill's changes to the Sales and Use Tax, Motor Vehicle Fuel License Tax, and Oil Severance Tax Law, except to the extent those provisions affect the department.

SUMMARY OF AMENDMENTS

The bill as introduced December 8, 2008, expressed the intent of the Legislature to enact changes to the Budget Act of 2008.

The December 19, 2008, amendments removed the intent language and added the provisions discussed in this analysis.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

The bill language states that the purpose of this bill is to address the fiscal emergency proclaimed by the Governor on December 1, 2008.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009.

POSITION

Pending.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Selvi Stanislaus	04/01/09
_______ N	_______ OUA	___X___ PENDING		

ANALYSIS

FEDERAL/STATE LAW

Federal tax law imposes six different income tax rates on individuals, estates, and trusts ranging from 10% to 35%.

Existing state tax law imposes six different rates under the Personal Income Tax Law (PITL) ranging from 1% to 9.3%. Each tax rate applies to a different level of income known as a "tax bracket." In addition, current state tax law requires the Franchise Tax Board (FTB) to recalculate the tax brackets each year based on the change in the California Consumer Price Index (CCPI).

For taxable years beginning on or after January 1, 2005, state law imposes an additional 1% Mental Health Tax (MHT), not subject to reduction by credits, on the portion of a personal income taxpayer's (PIT) taxable income that exceeds $1 million. The taxable income threshold of $1 million is not indexed based on changes in the CCPI. The MHT is subject to estimated tax payment requirements, interest, penalty, and other tax administration rules.

On an annual basis, the FTB is required to provide the Employment Development Department (EDD) with wage withholding tables to be used by employers to withhold taxes on wages paid to their employees. The tables are based on the estimated amount of tax due on the wages paid by the employer. In addition, employers required to withhold tax on supplemental wages can use a method that applies a fixed rate to the supplemental wage amount. This rate is 6% for supplemental wages other than stock options and bonus payments. The rate of withholding for stock options and bonus payments is 9.3%.

Taxpayers are required to make estimate payments if the amount of taxes withheld or otherwise available for a taxable year is less than the amount due. Penalties are imposed if a taxpayer underpays estimate taxes.

THIS BILL

For taxable years beginning on or after January 1, 2009, this bill would impose a 2.5% additional tax on the total tax for all personal income taxpayers.

This bill would define "total tax" as the tax imposed under the PITL, less any credits allowed under Chapter 2 of the PITL, other than the Child and Dependent Care Credit. The "total tax" imposed under the PITL includes income tax or alternative minimum tax (AMT) and, for taxable income greater than $1 million, the mental health tax. This "total tax" would be subject to the 2.5% additional tax described under this bill. The 2.5% additional tax would be subject to the same interest, penalty, and other tax administration rules as the taxes imposed under the PITL.

In addition, this bill would require that the 2.5% additional tax can only be reduced by the Child and Dependent Care credit and no other credits allowed under Chapter 2 of the PITL. Credits codified in other chapters of the PITL can be applied to reduce this tax.

For taxable years beginning on or after January 1, 2010, this bill would require FTB to report an increase in revenues for the 2009 calendar year, and each calendar year thereafter, attributable to the 2.5% tax rate. This report would be made available to the Director of the Department of Finance by a time determined by the Director.

Based on the information provided by FTB, the State Board of Equalization, and the Department of Conservation, DOF would be required for the 2010 calendar year to adjust the 2.5% tax rate to achieve revenue neutrality for all calendar years. That adjustment would take into account any actual net revenue gain or loss in the year preceding the year for adjustment, as well as its estimate of the projected revenue gains in the year following the year of the adjustment.

This bill would require that the tax withholding tables be adjusted for the 2.5% additional tax rate for the calendar year beginning January 1, 2010.

This bill also provides that no penalty shall be imposed for an underpayment of estimated tax to the extent the underpayment was created or increased by the proposed 2.5% additional tax.

This bill specifically provides that if certain provisions are held invalid by a court of competent jurisdiction, none of the provisions of the bill shall have any effect.

LEGISLATIVE HISTORY

ABX3 3 (Stats. 2009, Ch. 10) added 0.25% to each PIT and AMT rate for taxable years 2009 and 2010. In addition, this bill decreased the dependent exemption credit to the same amount as the personal exemption credit for taxable years 2009 and 2010.

AB 2372 (Coto, 2008) would have imposed an additional 1% tax on taxable income in excess of $1 million for the College Affordability Fund. This tax, combined with the existing MHT, would have effectively created an 11.3% tax rate for PIT taxpayers with taxable income in excess of $1 million. AB 2372 failed to pass out of the Assembly Appropriations Committee.

AB 6 (Chan, 2005)) would have reestablished PIT rates of 10% and 11% and would have increased the AMT rate for PIT taxpayers to 8.5%, but also would have reduced the amount of tax paid under the increased tax rates by the amount of tax imposed under Proposition 63, the MHT. AB 6 failed to pass out of the house of origin by the constitutional deadline.

Proposition 63 (Steinberg), approved by voters in the November, 2004, General Election, imposes a 1% tax on taxable incomes in excess of $1 million to provide a dedicated funding source for the expansion of mental health treatment options for children, adults, and seniors.

AB 1403 (Coto, 2005), AB 4 (Chan, 2003), and SB 1255 (Burton, 2002) would have reestablished PIT rates of 10% and 11% and would have increased the AMT rate for PIT taxpayers to 8.5%. AB 1403 failed to pass the Assembly Revenue and Taxation Committee; AB 4 and SB 1255 failed to pass out of the house of origin by the constitutional deadline.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not have a personal income tax. *Illinois, Massachusetts,* and *Michigan* impose a flat tax of 3%, 5.3%, and 4.35% respectively. *Minnesota* and *New York* have a progressive rate. *Minnesota* has a maximum tax bracket of $71,591 for single and $126,580 for joint filers, with a maximum tax rate of 7.85%. *New York* has a maximum tax bracket of $20,000 for single and $40,000 for joint filers, with a maximum tax rate of 6.85%.

These amounts and rates apply to returns filed in 2009 for the 2008 taxable year.

FISCAL IMPACT

The department's costs to administer this bill are estimated at approximately $337,000 (3.6 PYs) in the first year to program, develop, and test the additional tax increase within existing systems. Staff estimates on-going annual costs of approximately $726,000 (10.2 PYs) to revise tax forms, process all revised tax returns, postage and printing for tax notices, and respond to taxpayer inquiries resulting from the additional tax increase.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gains.

Revenue Estimate for ABX1 2 Effective for Tax Years BOA January 1, 2009 Assumed Enactment Date Before December 31, 2008 ($ in Billions)			
	2009-10	2010-11	2011-12
2.5% additional tax	$.150	$1.5	$1.2

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this provision would depend on the amount of current law final tax liability for PIT taxpayers for taxable year 2009 and subsequent taxable years and how quickly taxpayers respond to the increase in tax liability by adjusting their withholding and estimated payments.

The Department of Finance projects PIT final tax liability (total tax due) for taxable year 2009 is expected to be approximately $44 billion. Two and a half percent of $44 billion yields a tax increase of $1.1 billion ($44 billion X 2.5% additional tax increase = $1.1 billion). It is assumed some taxpayers would adjust their withholding and estimated payments in 2009. Therefore, approximately 14% of the 2009 revenue gain, or $150 million, would be realized in the 2009/10 fiscal year ($1.1 billion 2009 tax increase X 14% ≈ $150 million). It is assumed that for taxable year 2010 and subsequent years, taxpayers' estimated payments and withholding would be adjusted to reflect the higher tax liabilities.

LEGISLATIVE STAFF CONTACT

Legislative Analyst
Angela Raygoza
(916) 845-7814
angela.raygoza@ftb.ca.gov

Revenue Director
Jay Chamberlain
(916) 845-3375
jay.chamberlain@ftb.ca.gov

Legislative Director
Brian Putler
(916) 845-6333
brian.putler@ftb.ca.gov